Between Freedom And Democracy

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ABSTRACT

Is there a fundamental conflict between a political democracy as we know it and a free market, private enterprise or capitalist system? William Meckling and Michael Jensen of the University of Rochester, New York, believe that indeed there is, and that it is only a matter of time before the political sector eliminates most of the freedoms we still enjoy in the private sector of the economy.

The first part of this study, contributed by Michael Jensen, describes the gradual destruction of individuals" rights and the attack on business corporations; the second part, by William Meckling, discusses why freedom is being destroyed, how the press helps governments to destroy it, and what can be done to stop it.

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Part I: The destruction of rights

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The incompatibility between democracy and free markets concerns me for two reasons:

(1) I happen to value freedom more than anything else in the world. Virtually all the freedoms which I believe are truly valuable emanate from the existence of free markets and the rights of contract (for example, the right to work for whom I please, under any compensation arrangement mutually agreeable to both the employer and myself, the right to spend my income in any way I choose, the right to travel where I choose, etc.). The rights of free speech and the right to vote and the

other political freedoms which we normally hold in such high regard are important to me only to the extent that they influence our abilities to protect the freedom of choice granted to us in the private sector of the economy

(2) With the elimination of many of these rights and freedoms will come a substantial reduction in our real standard of living—our wealth.

But I predict that our children will live in a world in which they will be far less free and much poorer. This is all the more depressing when we realise that, although real economic freedoms are inconsistent with many forms of political democracy, they certainly don't seem to be consistent with any other form of government such as a dictatorship, socialism, or a monarchy.

Unfortunately, the problem is not the result of a premeditated conspiracy of a few left wing, socialist, communist or liberal radicals—if it were, it would be much easier to deal with. The basic problem which lies at the heart of the inconsistency between *democracy and free enterprise* and *democracy and freedom* is the following:

Individuals can make themselves better off in two major ways:

(1) By expending time and other resources operating in the private sector to produce goods and services which other people wish to buy.

(2) By expending resources in the political sector to get the government and the courts to change the rules of the game to reallocate wealth from others in society to themselves.

In the first of these activities we generally make other people better off and in the second, we make them worse off.

We make them worse off for two reasons:

(1) The direct effects of the wealth transfers, and

(2) The indirect effects caused by the reduced incentive to produce, which follows from foreign trade restrictions, production restrictions, licensing restrictions which prevent entry into various professions and markets, and the attenuation of property rights caused by significantly increased uncertainty over what the future rules of the game will be.

These latter effects, the effects on production, are by far the most important and in the long run, they amount to killing the goose that laid the golden egg.

The role of government and the revocation and abrogation of rights

Government plays two distinct roles in the operation of the property rights system. On the one hand it establishes the rules of the game; that is, it prescribes rules that determine which individuals have what rights. On the other hand, it acts as umpire or referee; it adjudicates disputes over which specific individuals have what rights, and it has a responsibility to see that the rules are followed

It is the first of these roles, the capacity of government to change the rules, that lies at the heart of the problem which concerns me here. As the rule maker, government can and does frequently *revoke* rights, i.e., it decrees that henceforth it will not be legal for individuals to use their property, or to enter into contracts in ways which heretofore had been sanctioned. When the government decrees that new automobiles sold in the United States must meet certain safety, antipollution, and fuel consumption requirements, they are revoking certain rights to use assets held in the name of the owners of firms and the rights of consumers to purchase products without these devices. Price and exchange controls revoke rights in the use of money, and thereby reduce the value of money (ironically, under the guise of preventing devaluation of the money).

In addition to taking actions which revoke general classes of rights, however, the government also uses its powers to *abrogate* specific contracts between individuals. Abrogation occurs when governmental authority is used to deny without compensation the rights of individuals who are party to a contract which has been created as a consideration in an exchange. This is what the US government did to the bondholders of the New York Port Authority, New York City, and the Penn Central Railroad. This is also what various European governments have been doing to stockholders through the passage of codetermination laws and job security laws.

In recent times we seem to have witnessed a major upsurge in the revocation of rights in the United States. Examples abound, and I mention only a few to illustrate the form and scope of the problem.

(1) The first peacetime imposition of wage and price controls in the United States in August of 1971.

(2) Environmental programmes which essentially give to the state the final authority to decide on much commercial activity—especially construction and much heavy industrial production.

(3) Various land use planning and control laws.

(4) The spread of rent controls in metropolitan areas such as Washington, D.C., and Boston.

(5) The provisions of the Occupational Safety and Health Act (OSHA) which limit the freedom of individuals to contract with employers to work under more hazardous conditions in return for higher pay.

(6) Various *affirmative action programmes* of the Department of Health, Education and Welfare, which limit the employment policies of organizations.

(7) Mine safety laws which have resulted in the closure of thousands of small mines without any measurable impact on safety.

(8) The recent Federal Pension Reform Act (ERISA) which limits the type of pension programmes which firms may offer to their employees.

(9) The regulation of the oil industry by the Federal Energy Administration which fixes the prices of output, and imposes production controls.

All of these rights have been revoked without compensation to any of the parties who are forced to bear the costs, whether they be owners of the land, utilities, water, rental property, employees in the industries involved, or consumers of the product. Revocation has not been treated as an eminent domain proceeding under which the state is required to compensate the property owners.

The destruction of the corporate form

Corporations in the United States have been, and will continue to be, the focus of a major attack. They are being asked to solve myriads of so-called social problems—discrimination, enrichment of the poor, training of the untrained, the clean-up of the environment, etc. The situation in Europe does not seem to be too different.

What this trend amounts to is a requirement for the corporation to bestow benefits on one group at the expense of another group—that is, to transfer wealth. In almost all cases the wealth transfer is from the *owners* of the corporation (i.e., stock and bond-holders) and consumers of the product, to these other groups-women, blacks, consumers of a clean environment, etc.

Whether you think these wealth transfers are good or bad, desirable or undesirable, is purely a matter of a personal value judgment which an economist, as a scientist, can say nothing about. However, an economist should be able to analyse the impact these changes will have on the corporation.

Corporations can in the long run behave in a *'socially responsible'* way only to a very limited extent. When it becomes clear that 'socially responsible behaviour' is abrogating the ownership rights of the owners, the values of corporate ownership claims will fall in the capital markets (as they have) and corporations will be unable to raise new capital or be able to raise it only at very high cost. It is not the welfare of current stockholders which matters here, but rather the reduction in human welfare.

The implementation of the notion of corporate responsibility is equivalent to the imposition of special taxes on the owners of corporations and consumers of the product. At some point where the expected future cash flows to the owners are sufficiently small and sufficiently uncertain, those claims will become worthless (like the value of many rent-controlled apartments in New York City which continue to be abandoned at record rates). In this event the corporation will be able to remain in business only to the extent that it can finance its operations out of internally generated cash flows or through financing or subsidies from the public sector. Along with the subsidies come controls and eventual public takeover. The Penn Central Railroad in the United States is an example and England has experienced the same process a number of times.

Corporations are becoming increasingly entangled in a web of regulatory and statutory constraints which constrain the executive's opportunities to make decisions in the stockholders' interests. Not only are there more and more constraints, but they are changing more rapidly as time goes on.

The fact is that the claim represented by a share of General Motors or Kodak stock is now very different from what it used to be—and I predict this trend will not be reversed.

The crucial role of rights

The value of a right to an individual depends on how transitory (or how permanent) that right is believed to be. Tenuous rights, rights which are likely to be revoked on short notice, or abrogated when the owner attempts to enforce them, will be of little value.

Uncertainty in the structure of rights or in the 'rules of the game' substantially changes both peoples' behaviour and the use of resources. In particular, it significantly reduces private investment in the kind of long-term projects which have played such an important role in determining our standard of living. It is very difficult to observe these effects because they primarily involve actions not taken, that is, projects not undertaken, buildings not built, and so are not the stuff of which newspaper headlines arc made. Nevertheless, their impact is substantial.

The low standard of living in South America and other underdeveloped countries is due in large part to the uncertainties in contract and property rights induced by the tremendous instabilities of the political system—uncertainties and instabilities brought on by revolutions, nationalisations, imposition of exchange controls, wage and price controls.

The remarkably poor performance of the stock market in the United States over the past decade is due in substantial part to the fact that the concentration of wealth in large publicly held corporations is particularly susceptible to expropriation through changes in the legal, political and regulatory climate. The total real return on the Standard & Poors 500 (adjusted for inflation) over the period 1965-1975 was *minus* 20 per cent. For the decade 1964-1974 it was *minus* 31 per cent. Since 1926, *no other* 10-year period has shown such low returns as these two, even including those of the Great Depression and market crash in the 1930s. The real rate of return on all common stocks on the New York Stock Exchange from 1926 to 1965 was about 7·2 per cent per year. If stocks had risen in price enough in the period 1965-1976 to provide investors with this same average inflation-adjusted return, the Dow Jones Index would now be at a level of about 2,600 instead of 930. Furthermore, the inflation—adjusted total market value of publicly held companies in the United States fell by $388 billions over the 10-year period 19651975 or almost 50 per cent of its value. These facts are difficult to explain, because unlike the 1930s, we did not experience a major collapse in the economy during this period. Furthermore, the fact that the prices of assets which are far less susceptible to 'theft' by the political sector (such as gold, silver, other precious metals and art) have increased substantially over the same period provides additional evidence consistent with the hypothesis.

The effects of the destruction of private rights are also showing up now in the personal income statistics. The Department of Labour data indicate that the median real American family income after federal taxes and social security payments has declined in five of the last seven years. In fact, the 1976 income was less than 1 per cent above the 1967 figure (not allowing for increases in state and local tax increases which have been substantial).

Human rights versus property rights

Understanding the nature of private rights and the role of government in the system of rights is crucial to understanding why private rights are being gradually whittled away and why no stabilisation or reversal of that trend can be anticipated. In this connection, it is worth pointing out another brilliant fallacy, namely, the false distinction between so-called 'human rights' and 'property rights'. *All rights* are, of course, human rights; there can be no other kind. Those who use this distinction are simply resorting to a clever semantic ploy. They are fabricating a conflict between one kind of rights ('human') which are 'good' and another kind of rights ('property') which are 'bad'. Since all rights are human rights, the only possible conflict is between individuals—that is a conflict over which individual will have what rights.

Moreover, politicians, and bureaucrats, are as individuals no different from the rest of us. They prefer more rights to less; and they have the same incentive as the rest of us to expand the set of rights from which they benefit. It is this fact, coupled with the incentives each of us has to use the government to reallocate wealth and make ourselves better off that lies at the bottom of the conflict between political democracy and the market system. Our individual interest in having rights which are immutable is in direct conflict with the interest of bureaucrats and politicians who want to have the ability to alter rights at will.

The private corporation has been an enormously productive social invention, but it is being destroyed. It is a particularly vulnerable target for the marketing campaigns of politicians. Corporations represent large visible blocks of wealth. Corporate stockholders and creditors are a widely dispersed and incohesive group. The financial claims on the assets of corporations are often held by intermediaries—banks, insurance companies, pension funds, college endowments, etc.—so that many of the beneficiaries (depositors, insured individuals, students, etc.) are not even aware that they are the beneficiaries. Moreover, the market for these claims is both volatile and complex, so that even if the 'owners' are aware of their ownership, they cannot easily identify any decline in the value of their claims with the actions of government. Only a naive view of the behaviour of politicians would lead anyone to believe that they would pass up this obvious opportunity to use the corporation as a pawn in expanding their own power.

Corporations will tend to become like Conrail, Amtrak and the Post Office. They will be subject to more and more controls (similar to what is happening to the transportation and oil industries). There will be more public directors on large corporations. There will be more involvement of labour in the control and management of corporations such as is now happening here within Europe. When they are regulated into chaos, they will be subsidised and eventually taken over. For instance, if controls on the oil industry are not removed, it will certainly end up nationalised because, like the Penn Central, it won't work.

Co-determination laws

Co-determination laws have swept through Europe, without, it seems, many people bothering to analyse the potential impact. Analysing the behaviour of the co-determined firm is difficult because we do not have a theory that will tell us with much confidence how these mixed supervisory boards will behave.

Even in the 'parity' representation case, the supervisory boards could end up behaving as if they represented only the stockholders. Given the German law, for example, where the chairman, who is elected by stockholders, has the deciding vote in the case of ties, and where one of the labour representatives is from the salaried ranks, it is possible that the stockholders will have complete control over the affairs of the firm. Certainly in the short run, this is a reasonable prediction of how co-determination will work. In the long run, however, it is possible that co-determination will lead to the other end of the spectrum, that is, co-determination could end up effectively turning the firm over to labour.

If labour gets complete control of supervisory boards what will happen? My prediction: it will likely turn into the Yugoslav-type system with state ownership of productive resources—and all the problems of the Yugoslav firms. The Yugoslav workers do not have a capitalised claim on the entire future cash flow of the firm. They have claims on the cash flows which are contingent on their employment with the firm. In deciding on whether to invest additional resources in the firm (or to disinvest) such employees will use a very different criterion from that used by stockholders. They will want to invest additional funds in the firm only to the extent that the cash flows yielded by the investment prior to their own departure from the firm is sufficient to yield them an acceptable return. In effect, the workers have no claim on the principal amount they 'lend' (give is the appropriate word) to the firm as they would if they were to lend the same amount to a savings bank.

Consider for example a case where all the employees planned on retiring from the firm in one year. Then, if they could earn 5 per cent on their savings in a bank, they would not voluntarily invest those funds in the firm unless the total returns in the first year were 105 per cent. If their horizon was five or ten years their own required rate for internal investment would have to be 23 per cent and 13 per cent to be equivalent to the 5 per cent bank rate. Similarly, they will find it desirable to stop maintenance of equipment and even to sell off the assets of the firm to increase their current wages if the sacrificed returns are smaller than these numbers. This is the problem referred to in the literature on the Yugoslav firm as 'the workers eating up the factories'. Yugoslavia has had to pass laws imposing maximums on worker wages and preventing workers from reducing the book values of their companies' assets. Nevertheless, the problem still exists.

The co-determined supervisory board is essentially unstable. It will either remain controlled by stockholders or will become completely controlled by labour. If this happens, the scenario leading to the Yugoslav socialist system is likely to come about in the following way. Upon gaining control of the firm, the workers will begin 'eating it up' by transforming the assets of the firm into consumption or personal assets through various procedures. As this continues and the process becomes clear to the capital markets, the value of the stock will go to zero. It will then become very difficult for the firm to obtain capital in the private capital markets. As this continues, some firms will simply go out of business and others will reach the point where the returns on investment are so high that even given the horizon bias further reduction in the capital of the firm makes the workers worse off. The result of this process will be a significant reduction in the country's capital stock, increased unemployment, reduced labour income and an overall reduction in output and welfare. This state of affairs will lead to unfavourable international comparisons, outcrys of outdated technology, foreign exchange problems and a general clamour for state subsidies to capital accumulation to augment the 'failures' of the private markets. As the state provides capital loans to firms it will impose additional controls to prevent the workers from simply transforming the new resources into consumption. These controls will take many of the forms discussed in the Yugoslav case; requirements for maintenance of the capital stock, maximum possible wage payments, etc. The final result will be fairly complete (if not total) state ownership of the productive assets in the economy. If there is a minimum size below which firms are not subject to the co-determination laws (2,000 employees in the case of Germany), many firms will simply shrink through dissolution or spin-offs to sizes below this level to avoid the laws. If the laws are not changed to include these firms in the codetermined sector, the process will end there with those firms for which economies of scale are very large being socialised and most of the rest of the economy remaining private but incurring the inefficiencies resulting from the diseconomies of small scale operation.

Part II: The theory of representative political democracy

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I would like to begin by discussing why the political sector in Western democracies is gradually destroying the market sector. To do so amounts to developing a theory about why we get the kind of government we get. It would be fraudulent for me to pretend I have a fully satisfactory theory. What I have is some bits and pieces of theory and evidence which I believe are important elements in the jigsaw puzzle, but will not make a complete picture.

Since such governments are made up of politicians and bureaucrats, we must begin with them as the basis of our analysis. Most political theory and political economy simply assumes that politicians and bureaucrats behave in the public interest. From a scientific viewpoint, the assumption that men who happen to be part of the government behave in the interest of others while men in the marketplace behave in their own interest is simply indefensible. While those who run for political office are a self-selected group, there is no reason to believe we can successfully construct a theory of behaviour based on the assumption that they will somehow always do what is good for society. To understand political processes, we must abandon the view that politicians simply act in the interest of others, and in its stead, accept the view that politicians are like others acting in their own interest. This is not, of course, a condemnation either of politicians or of others. It is simply a reflection of the fact that the model of human behaviour which has been most successful in explaining what we observe in the world is one based on self-interest.

It is not enough, however, to recognise that politicians act in their own self-interest. We must recognise that they are not passive actors, simply collecting information about what their constituents want in order to act on it. If that was what they were doing, we would expect to observe them spending their time and resources polling or otherwise surveying their constituents to find out what they want done and how they want them to vote on specific issues. What we actually observe is politicians making speeches designed to sell points of view to the listeners.

Politicians must be viewed as entrepreneurs in their own right, just like any manager in the private sector. They promote and sell their product like any firm promotes and sells its product. Their product, of course, is simply an increased role for government. This is why they want to abolish private rights: abolition of private rights effectively gives them more power. Stability in private rights is by its very nature a constraint on what government (i.e., bureaucrats and politicians) can do. The more difficult it is to enact law, issue administrative rules and regulations, or make court decisions which revoke or abrogate individual rights, the more restricted is the domain of the bureaucrat and politician. To the extent that government's power to revoke or abrogate rights is limited, the market for the services of individuals in government is limited. Revocation and abrogation of rights is the currency in which politicians and bureaucrats deal. Like all of us, they are constantly searching for ways to expand the market for their services. To do so, they must effectively break down the system of private rights because it limits their market.

The crisis policy

As marketers, they employ strategies which they find successful just as marketers do in the private economy. One such strategy is the practice of creating crises, or more accurately, the impression of crises, which demand government action to save us all from impending disaster. The creation of crises is an old political strategem. 180 years ago, James Madison described it as:

> 'The old trick of turning every contingency into a resource for accumulating force in the government.'

Politicians in the United States have used this ploy as a pretence for expanding their powers in one area after another in recent years. Thus, we have had crises over air and water pollution, automobile safety, the quality and safety of consumer products, particularly drugs and food, the preservation of forests and wildlife, land use, occupational health and safety, so-called 'illicit' payments to foreign officials—the list is almost endless. The one receiving most attention currently, of course, is the energy crisis.

The scenario for all of these crises is the same, they usually involve hearings by the Congress, perhaps accompanied by the appointment of semi-official citizens' commissions asked to investigate the problem. Often there is some 'public interest' group in the background—like Nader's Raiders. At every opportunity the politician entrepreneurs make exaggerated statements about the seriousness of the problem. As in the case of energy, both sides (Democrat and Republican) agree that disaster is imminent—they only disagree over what ought to be done to avert it. The press and radio are delighted. Crises sell newspapers and attract TV viewers. The key participants are invited to appear on the morning talk shows and on the weekly panel shows to discuss their points of view. The President finally presents his plan for solving the crisis to Congress. Congress massages the President's recommendation to satisfy the various interest groups, and finally something in the way of a new law emerges which inevitably restricts our freedoms, transfers power to the government, reduces the general welfare, but makes some special interest groups better off.

Homo-boobus

If we are ever to understand why we get the kind of government we get, we must understand why these crisis campaigns are so successful. Why is the public so easily led to accept the crisis as real? I suspect that not one of my readers would agree that the entire energy crisis is nothing but a political trick. Nevertheless, I am confident that is all it is, and I am willing to bet I could convince many of you of that view given enough time. To illustrate my point about how the public is led around by the nose in these matters, however, I need only point out that a few years ago the public was persuaded by the politicians of that day that the OPEC cartel was perpetrating a disaster by raising the price of gasoline in the United States from 40c per gallon to 60c per gallon. Now we are told by Mr. Carter that it will be good for all of us if Congress levies taxes on gasoline which would (gradually) raise the price from 60c per gallon to perhaps as much as $1.10 per gallon. In brief, within the space of three years the public has been conned into believing exactly opposite views, both of which, I might add, are completely false.

H. L. Mencken, the famous newspaper columnist of the first half of this century, was fond of referring to the public as Homo-boobus. He understood and described in detail for the benefit of others how newspaper writers could create crisis as a way of selling newspapers and effecting political change. Mencken, however, simply had a low regard for the average man's intelligence. In fact, we know that the average man is very intelligent when it comes to actions which affect his own well-being. Why is he such a dupe about political and economic policy matters? The answer is very simple. Man has a limited computer; he can store and process only a limited amount of information. If he is maximising his own well-being he will use that limited computational facility for solving those problems over which he has some control, and for making those decisions where he can affect the outcome.

He gets no real benefit out of studying and analysing policy issues revolving about the energy shortage, environmental problems, etc. If he is at all realistic, he will understand that he can do absolutely nothing about influencing policy on such issues. Why should he waste his limited computer on the economics of energy policy when he hasn't planned his next vacation or he wants to plan an addition to his house, or he is worried about the friends his children are associating with? The latter are all problems which he can use his computer to do something about—to change the state of affairs for what he would regard as the better.

The press and the media

The truth is, that in order to get man interested in political and economic affairs at all, we must do so as a form of entertainment. What he knows and believes about economics and politics is generally what he gets from the popular press and the media. Recognising the role which entertainment plays in providing the average man with his views on policy matters, brings us to the question of why the press and the media always seem to be encouraging the entrepreneurial endeavours of the politicians. With the assistance of the media and press, the politician's marketing strategies enable him to sell to the public a role for government which they would otherwise never permit it to assume. It would be hard to find a more telling example of the effectiveness of such marketing techniques than the success which the politicians seem to be having in the United States in convincing us, the public, that they will make us all better off by imposing heavy taxes on automobiles, gasoline, and crude oil—that we can all be made better off by denying ourselves a consumer good for which there is clearly a great and growing demand.

Most democratic governments today are representative in character, that is, primary responsibility for the legislative function is assigned to an elected body. Representatives sitting as a body take primary responsibility for the enactment of laws. But these representatives affect what kind of laws get enacted. Town-hall democracy or direct democracy as a political institutional arrangement will end up enacting a very different set of laws from what will be produced by a parliament, congress, or legislative assembly. For one thing, with direct democracy a different set of bills will be introduced for voter consideration than will be introduced in a legislative assembly. Indeed, it is clear that one of the functions of representative governments is to resolve the agenda problem—that is, to decide which acts will be considered. But even if the same set of bills is considered under these two political structures, different sets will be enacted. The reason is the practice of logrolling—or vote-trading. Log-rolling is the practice of minorities forming coalitions where the members agree to vote favourably on bills which they would otherwise oppose in exchange for favourable votes on bills which they themselves want to have enacted. Log-rolling is a potential explanation for a phenomenon we in the United States observe fairly commonly, namely, that many laws are enacted which damage a large number of individuals and bestow benefits on a tiny minority. Milk price supports and tariffs on watches and bicycles are examples. Such laws would have little chance of enactment in a direct democracy. There is substantial evidence that foreign aid, including the budgets for the numerous lending agencies like the World Bank and the International Monetary Fund, would be very much less than it is if it were submitted to popular referendum. Public opinion surveys in the United States generally find very little sympathy for foreign aid of any kind. In Switzerland, a foreign aid programme enacted by its parliament was overwhelmingly rejected in a referendum.

Indeed, there can be little doubt that government as a whole would be significantly smaller than it is if budgets and the taxes to finance them had to be approved every year in a referendum—particularly if the budgets and taxes were broken down into a reasonable number of categories, say by departments. It is doubtful, for example, that public welfare expenditures would be a fraction of what they are now if they had to be approved at a referendum each year.

Vote-trading or log-rolling provides a potential explanation for why at each session of our legislative bodies we get a set of laws enacted which include some acts which would never be approved in a direct democracy. In that sense, it tells how it is possible to violate ‘majority rule’ in a representative democracy. But the log-rolling model cannot be pushed too far. In particular, vote-trading cannot explain why we get the particular coalitions or vote-trades that we actually get. Vote-trading is a neutral phenomena. The traders include defenders of markets as well as attackers. For that reason, vote-trading cannot be used to explain the growth of the government sector relative to markets. To deduce growth in government, some phenomenon has to be introduced which will bring about the bias.

Lobbying and organised political activity

Other pieces which we must fit into the puzzle before we have an acceptable theory of political democracy include lobbying, and what we might call organised political activity. Strongly held normative views about the immorality of lobbying aside, we have no theory which will explain why legislators (or regulators) should pay the slightest attention to lobbyists, unless, of course, lobbyists are simply there to buy (more or less literally) support for those who pay their salaries. But then we must ask, what do they use for currency in this purchase? If the lobbyist offers only votes from his constituency, why can't the politician attract those same votes without the services of the lobbyist?

Lobbying, of course, is not the only form of organised effort designed to influence the political process. In the last two decades we have witnessed increasing use of violence as a way of influencing the political process. Social approval for group use of violence has in the Western world been fostered primarily by granting labour unions so-called 'rights to strike', which really are a denial of the rights of employers to dismiss employees, and a denial of the rights of other individuals to accept employment as replacement for workers who are on strike. This is generally accompanied by a tacit refusal on the part of local law-enforcement agencies (which are themselves organised) to enforce private property rights. Once some groups with the tacit approval of society successfully exercise violence, others will not be far behind. Thus, we see organised marches and vigils, occupations of buildings and building sites, and in the extreme, political kidnappings and murders, all designed to influence the political process. Much of this kind of activity is not only approved of by politicians, but also encouraged and instigated by them. Moreover, the press and media play an enormously important role. Such activities are the fuel which fires the crisis creation process as a forerunner of political action.

What to do about it?

There are two levels on which to discuss that question. The first has to do with what kind of structural changes might be effected in political democracy to prevent it from destroying both markets and itself. These we might call 'constitutional reforms'. I mention a few not because we are convinced that they will have the 'desired' consequences, but more as examples of the magnitude of the reform we think will be required to create a democratic framework within which private markets and freedom are more viable.

One such reform has been suggested by our vote-trading discussion. It is to make much more extensive use of the referendum. The Swiss already have both the legal framework and the tradition of extensive use of the referendum. We believe this gives them a significant element of protection against government encroachment, which other Western democracies lack. It is instrumental to their prosperity and explains why government expenditures there tend to be a much smaller fraction of the GNP.

A second reform is suggested by the discussion of the expropriation of rights. It is to significantly extend the compensation principle—at the extreme, to require that the government must fully reimburse anyone from whom it takes rights.

A third kind of reform would be to institute much more liberal rules for secession by political sub-units or geographic areas. This would provide a control on central governments in terms of how far they can go in taking wealth from some and giving it to others. The problem, of course, with secession is that of economies of scale in both government services and in private production. If secession leads to very small governmental units, they may find it difficult to form coalitions to take advantage of economies of scale in such services as defence. More to the point, if they engage in protectionist economic policies of the sort many nations follow today, secession will adversely affect our economic welfare by discouraging exploitation of comparative advantage and scale economies.

Even if we could agree on the above reforms or some others, Michael Jensen and I have no idea how one could bring such reforms about. We do not know how to get from here to there. The usual prescription is to educate the public to get their support. While the realisation of that goal cannot be ruled out arbitrarily, those who propose to educate the masses seem to us at least, to be very naive about the magnitude of the task.

The real difficulty is Homo-boobus. We must all recognise that the public has no incentive to understand how either the political or economic systems operate. If they are to be given that understanding, we are going to have to learn how to get the media and the press not only to present complicated theories, but to do so in an entertaining way.

Summary

When Marx said that capitalism contains the seeds of its own destruction his analysis as usual was wrong. It is political democracy which carries the seeds of its own destruction though markets will be an early casualty in that process. Without economic freedoms, without property rights, voting rights cannot long survive. It is important to recognise that the demise of markets and political democracy will not be the end of man, however. Surely, a fair reading of history suggests that man's fate is one of tyranny rather than freedom. What we have to explain is the unusual state of affairs in the last 200 years.